

Message Text

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FM AMEMBASSY LONDON

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C O N F I D E N T I A L SECTION 01 OF 04 LONDON 00671

PASS TREASURY AND FRB

E.O. 11652: XGDS-1

TAGS: EFIN, UI

SUBJECT: HIGHLIGHTS OF AMBASSADOR RICHARDSON'S FAREWELL
CALL ON CHANCELLOR HEALEY

SUMMARY: AMBASSADOR RICHARDSON'S FAREWELL CALL ON THE
CHANCELLOR PROVIDED A TOUR D'HORIZON OF HEALEY'S MAJOR
PREOCCUPATIONS FOR THE FUTURE. CHANCELLOR CITED CONTINU-
ING REDUCTION IN THE RATE OF DOMESTICALLY GENERATED IN-
FLATION AND UNIONS' ACCEPTANCE OF UNEMPLOYMENT AND NEED
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FOR AN INCOMES POLICY AS MAJOR SUCCESSES TO DATE. THE

NEXT NINE MONTHS WILL BE CRUCIAL FOR HIM. UNEMPLOYMENT WILL CONTINUE TO RISE IN CONJUNCTION WITH A DECLINE IN THE LEVEL OF REAL INVESTMENT IN MANUFACTURING. THERE WILL BE INCREASING STRAINS ON HIS RELATIONS WITH THE TRADE UNION LEADERS. IN GENERAL, HE BELIEVES THE RELATIONSHIP WILL REMAIN GOOD, BASED ON AN ACCEPTANCE OF EXISTING REALITIES AND FUTURE DIFFICULTIES FACING THE UK, IE, THE NEED TO REDUCE UNEMPLOYMENT, INCREASE PRODUCTIVITY AND CORRECT ITS BALANCE OF PAYMENTS DEFICIT. VISIBLE AND STEADY PROGRESS EVEN IF SLIGHT WILL BE AN IMPORTANT FACTOR IN REBUILDING CONFIDENCE AND IN ENABLING THE COUNTRY TO FINANCE ITS BALANCE OF PAYMENTS DEFICIT, WHICH HAS BEEN A CHRONIC PROBLEM SINCE THE END OF THE SECOND WORLD WAR. THERE WILL BE CONTINUED PRESSURE FOR IMPORT CONTROLS AS ONE MEANS OF ALLEVIATING THE DOMESTIC PRICE TO BE PAID IN ESTABLISHING A BETTER EQUILIBRIUM IN THE ECONOMY. THE CHANCELLOR BELIEVES THESE PRESSURES CAN BE SUCCESSFULLY RESTRAINED. HE CONSIDERS THAT THE JAMAICA INTERIM COMMITTEE SESSION WENT WELL DUE LARGELY TO FANTASTIC CHANGE IN THE WILLINGNESS OF THE FRENCH TO COMPROMISE THEIR POSITIONS. END SUMMARY

1. AMBASSADOR RICHARDSON ACCOMPANIED BY ECONOMIC MINISTER AND FINANCIAL ATTACHE PAID FAREWELL CALL ON CHANCELLOR HEALEY ON JANUARY 13. CHANCELLOR RECALLED HIS REMARKS ON JAMAICA MEETINGS IN HOUSE OF COMMONS PRECEDING DAY (LONDON 557), CONSIDERED THAT THE MEETINGS WENT WELL AND NOTED "FANTASTIC CHANGE IN THE WILLINGNESS OF THE FRENCH TO COMPROMISE." FOREIGN MINISTER FOURCADE'S POSITION WAS MORE FLEXIBLE, IN CONTRAST TO PREVIOUS FRENCH POSITIONS WHICH ALLOWED NO COMPROMISE. AGREEMENTS REACHED REPRESENT WHAT IS BASICALLY "AN ENORMOUS SHIFT" FROM EARLIER FRENCH INTRANSIGENT VIEWS. HE NOTED WHAT HE CALLED AN "EXTRAORDINARY FRENCH-AMERICAN ALLIANCE." AT LEAST PARTIALLY, THIS MUST REFLECT GISCARD D'ESTAING'S COMING TO TERMS WITH REALITY. SINCE THE RAMBOUILLET SUMMIT, THE FRENCH HAVE TRIED THEIR BEST TO MAKE A SUCCESS OF THE MONETARY NEGOTIATIONS. THE SAME IS EQUALLY TRUE OF THE US. VIEWED AGAINST EARLIER US POSITIONS, CHANCELLOR ALSO NOTED SECRETARY SIMON'S MORE FLEXIBLE POSITION
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ON GOLD AS AN ELEMENT LEADING TO A SUCCESSFUL OUTCOME. THE JAMAICA MEETINGS ALSO POSED DIFFICULTIES FOR THE LESS-DEVELOPED COUNTRIES, WHICH WANTED A DOUBLING OF IMF QUOTAS. THEY EVENTUALLY SETTLED FOR LESS. HE HOPED HE HAD BEEN HELPFUL IN BRINGING ABOUT THEIR AGREEMENT.

2. IN REPLYING TO A REMARK FROM AMBASSADOR RICHARDSON ABOUT PROGRESSIVE WILLINGNESS TO LOOK AT FACTS MORE OB-

JECTIVELY, THE CHANCELLOR AGREED THAT THERE HAS BEEN A
RETURN TO REALITY, SAYING THIS IS ESPECIALLY TRUE IN THE
UK. IT IS REFLECTED IN POSITIONS BEING TAKEN BY THE
TRADES UNION CONGRESS (TUC). UNION LEADERS HAVE ADOPTED A
REALISTIC, COLSTRUCTIVE APPROACH. FURTHER DISCUSSIONS
ARE BEING HELD IN THE CONXT OF NATIONAL ECONOMIC DEVELOP-
MENT ORGANIZATION (NEDO) MEETINGS. DEPARTMENT OF EMPLOY-
MENT OFFICIALS ARE AMAZED THAT THE TUC HAS ACCEPTED THE
PROBABILITY OF UNEMPLOYMENT REACHING 1.4 MILLION IN 1976.
FALLING ONLY SLOWLY IN 1977 ALTHOUGH WITH PROJECTED BIG-
GER DECLINES IN UNEMPLOYMENT IN 1978. THEY HAVE ACCEPTED

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THAT THE SHORT-TERM SITUATION WILL BE PAINFUL.

3. CHANCELLOR STRESSED THEY HAVE ALSO ACCEPTED THE NEED FOR CONTINUED REDUCTION IN THE RATE OF INFLATION, HOPEFULLY DOWN TO A 6 PERCENT LEVEL IN 1977. THE CHANCELLOR IS STRESSING TO THEM THAT BALANCE OF PAYMENTS PERFORMANCE IS NOW A MAIN CONSTRAINT ON DOMESTIC POLICIES. GIVEN TIME LAGS, THERE IS LITTLE HE CAN DO TO IMPROVE THE COUNTRY'S ECONOMIC PERFORMANCE DURING THE NEXT YEAR OR TWO THROUGH INCREASED INVESTMENT. THE GREATEST POTENTIAL
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FOR SHORT-TERM ECONOMIC IMPROVEMENT LIES IN BETTER UNION-MANAGEMENT COOPERATION ON THE SHOP FLOOR WHERE THERE IS ENORMOUS SCOPE FOR INCREASES IN PRODUCTIVITY. THE STEEL AND AUTO INDUSTRIES ARE OBVIOUS EXAMPLES.

4. CHANCELLOR CONSIDERED THAT A FUNDAMENTAL SITUATION FACING THE COUNTRY IS THAT THE LEVEL OF INCREASED DEMAND HE CAN FEED INTO THE ECONOMY WILL DEPEND ON THE SUCCESS OF THE WAGE RESTRAINT POLICY. ANY INCREASE IN DEMAND WILL HURT THE BALANCE OF PAYMENTS, WHICH CAN ONLY BE SUCCESSFULLY FINANCED IF THERE IS A LOWER RATE OF INFLATION. IN ESSENCE, THIS IS THE FUNDAMENTAL SITUATION FACING THE COUNTRY.

5. THE CHANCELLOR ADDED THAT HE FACED EQUALLY DIFFICULT PROBLEMS WITH THE BUSINESS AND BANKING COMMUNITIES, GIVEN THEIR FAILURE TO PROVIDE RENEWED INVESTMENT IN PLANT AND EQUIPMENT. THE UNIONS WANT TO SEE NEW INVESTMENT IF THEY ARE TO MAKE CONCESSIONS ON WAGE RESTRAINT OR RELAXED PRICE CONTROLS. THERE IS A CREDIBILITY PROBLEM. THE CLIMATE WITH THE UNIONS HAS SHOWN ENORMOUS IMPROVEMENT DURING THE PAST 6 MONTHS, BUT LOOKING AHEAD THE CHANCELLOR SEES A DIFFICULT 9 - 12 MONTHS WITH INCREASING STRAIN ON HIS RELATIONSHIP WITH THE UNION LEADERS AND THE UNIONS IN GENERAL. ON BALANCE, HE BELIEVES "IT WILL HOLD."

6. ELABORATING, HE SAID HE NEEDS THE NEXT 9 MONTHS IN ORDER THAT THE UPTURN IN DOMESTIC ACTIVITY CAN BE SEEN TO BE TAKING HOLD, WHICH IN TURN WILL LEAD TO A FALL IN UNEMPLOYMENT, BUT WITH ABOUT A 6-MONTH LAG. THE UNIONS' REACTIONS THUS FAR HAVE BEEN CONSTRUCTIVE AND REALISTIC. THE CHANCELLOR AGREED WITH AMBASSADOR RICHARDSON THAT A CRITICAL POINT IS THE TREND OF OVERALL ECONOMIC PERFORMANCE WHICH MUST BE SEEN BY THE GENERAL PUBLIC TO BE IMPROVING, EVEN IF SLOWLY. FORECASTS INDICATING A BETTER

SITUATION 12 - 18 MONTHS HENCE CAN PLAY A ROLE IN BRING-
ING ABOUT THE CRITICAL NEED FOR ACCEPTANCE IN HOLDING THE
LINE ON WAGE INCREASES AND ACQUIESCENCE IN UNEMPLOYMENT
LEVELS THAT ARE TOO HIGH.

7. BECAUSE OF NEGATIVE EFFECTS ON THE BALANCE OF PAYMENTS
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THE CHANCELLOR SAID THERE IS ONE GROUP OF H.M. TREASURY
OFFICIALS WHICH IS TERRIFIED AT THE IMPLICATIONS OF A
SHARP INCREASE IN NEW INVESTMENT. HE DID NOT AGREE WITH
THESE ADVISERS AND FELT THAT NEW INVESTMENT IN MANUFAC-
TURING COULD BRING QUANTUM IMPROVEMENTS IN INDUSTRIAL PER-
FORMANCE. CHANCELLOR STRONGLY AGREED WITH THE AMBASSADOR
ON THE NEED FOR MODERNIZING THE UK'S INDUSTRIAL BASE,
BUT ADDED IT WOULD TAKE AT LEAST TWO YEARS TO RETURN TO
THE APPROPRIATE BALANCE OF RESOURCES IN THE ECONOMY.
HENCE, THE NEED FOR A SUCCESSFUL ANTI-INFLATION PROGRAM.

8. THE CHANCELLOR HOPED THAT THE PERCENTAGE INCREASE
ALLOWED BY STAGE 2 WOULD BE LOWER THAN THAT IN THE
PRESENT PROGRAM (ROUGHLY AN 11 PERCENT INCREASE IN THE
ANNUAL WAGE BILL). HE PERSONALLY CONSIDERED THAT A THREE
PERCENT ANNUAL TARGET FOR WAGE INCREASES IN LINE WITH
PRODUCTIVITY WOULD BE APPROPRIATE BUT DID NOT THINK IT
COULD BE SOLD POLITICALLY OR TO THE UNIONS. IT WAS "ONE
HELL OF A PROBLEM" AND WOULD BE EVEN MORE COMPLEX BECAUSE
OF THE NEED TO SHIFT FROM A FLAT RATE OF INCREASE UNDER
THE PRESENT PROGRAM TO A MORE FLEXIBLE APPROACH. THE UN-
EMPLOYMENT PROBLEM WAS EQUALLY HELD BUT, PROVIDED OUT-
PUT BEGINS TO IMPROVE, THE CHANCELLOR THOUGHT IT WILL BE
MANAGEABLE. A RELATED PROBLEM IS TO ASSURE THE
UNIONS THAT ANY ADDITIONAL CASH FLOW TO THE BUSINESS
SECTOR EVENTUALLY WILL GO INTO INVESTMENT AND JOB
CREATION.

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9. IN REPLY TO A QUESTION FROM THE AMBASSADOR ON THE CONTENT OF THE FMRTHCING PLANNING AGREEMENTS WITH THE 30 TARGETED INDUSTRIES UNDER THE NEW INDUSTRIAL STRATEGY, THE CHANCELLOR REPLIED THAT THERE WOULD BE TRIPARTITE -- GOVERNMENT/LABOR/MANAGEMENT -- DISCUSSIONS WITHIN EACH OF THESE 30 INDUSTRY'S LOCAL ECONOMIC DEVELOPMENT COUNCILS (WHICH FALL UNDER NEDO). EACH ECONOMIC DEVELOPMENT COUNCIL WILL REPORT BACK IN JUNE ON WHAT CAN BE DONE IN EACH INDUSTRY, EITHER WITH OR WITHOUT CHANGE IN GOVERNMENT
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POLICY. PARTICULAR ATTENTION WOULD BE GIVEN TO INDUSTRIES WHERE A PARTICULAR CHANGE OR SHIFT IN APPROACH COULD RESULT IN BENEFITS TO A WIDER RANGE OF INDUSTRIES THAN JUST THE ONE BEING CONSIDERED. IN THE UK CONTEXT, THIS WOULD BE NATIONAL PLANNING.

10. THE CHANCELLOR SAID THAT PLANNING AGREEMENTS WITH

INDIVIDUAL COMPANIES WOULD BE VOLUNTARY. AT THE MOMENT, THERE IS VERY LITTLE INCENTIVE FOR THE COMPANIES TO CO-OPERATE IN TERMS OF VISIBLE BENEFITS IN RETURN FOR THEIR COOPERATION. SOME INDUSTRIES, SUCH AS CHEMICALS, PROBABLY DON'T NEED TO TAKE PART, ALTHOUGH THE CHANCELLOR BELIEVES THEY WILL. A KEY NEED WILL BE TO ESTABLISH CONFIDENCE BETWEEN THE INDIVIDUAL COMPANIES AND THE GOVERNMENT. THE CHANCELLOR AGREED WITH THE AMBASSADOR THAT ONE INCENTIVE TO THE COMPANIES MIGHT BE IN HELPING TO SHAPE THE GOVERNMENT'S INDUSTRIAL STRATEGY. THE CHANCELLOR WENT FURTHER, HOWEVER, ADDING THAT STEPS WOULD NEED TO BE CONSIDERED BOTH AT THE MICRO-AND MACRO-ECONOMIC LEVELS TO DETERMINE WHAT COULD BE DONE TO STIMULATE GROWTH AT THE LEVEL OF THE FIRM. THERE WOULD BE NO SANCTIONS OPEN TO THE GOVERNMENT IF COMPANIES DID NOT WISH TO COOPERATE, EXCEPT INFORMALLY FOR THOSE COMPANIES WHICH ARE MAJOR SUPPLIERS TO THE GOVERNMENT. ON REFLECTION, HE THEN ADDED THAT OF COURSE IF THEY DID NOT VOLUNTARILY COOPERATE AND WERE TO RUN INTO DIFFICULTIES, GOVERNMENT ASSISTANCE MIGHT BE WITHHELD FROM THEM BUT, EQUALLY, THE GOVERNMENT DID NOT WANT TO SEE THEM RUN INTO DIFFICULTIES.

11. THE CHANCELLOR DID NOT BELIEVE THAT NEW GOVERNMENT INCENTIVES TO INVESTMENT WOULD BE FORTHCOMING; THE UK PROBABLY HAS MORE OF THESE NOW THAN ANY OTHER MAJOR INDUSTRIALIZED COUNTRY. PERHAPS WHAT SHOULD BE DONE WOULD BE TO REDUCE INCENTIVES IN FUTURE YEARS IF INVESTMENT WAS NOT UNDERTAKEN IN THE CURRENT YEAR, I.E., SOME MEANS MUST BE FOUND TO STIMULATE INVESTMENT IN THE SHORT-TERM.

12. THE CHANCELLOR ACKNOWLEDGED THAT THE COMPANIES ARE CONCERNED WITH THEIR LIQUIDITY AND CASH FLOW POSITIONS AS THE ECONOMY MOVES INTO AN UPTURN. THEY ARE VERY ANXIOUS THAT PRICE CODE RESTRICTIONS SHOULD BE RELAXED IN ORDER TO
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ENABLE THEM TO EARN INCREASED PROFITS. HOWEVER, THERE WILL BE PRESENTATIONAL DIFFICULTIES WITH THE TRADE UNIONS WHO NEED TO SEE THE RELATIONSHIP BETWEEN RELAXED PRICE CODE RESTRICTIONS AND INCREASED REAL INVESTMENT. CHANCELLOR HAS MADE THIS POINT TO THE CONFEDERATION OF BRITISH INDUSTRY (CBI) LEADERS WITH WHOM HE THINKS HE HAS GOOD RELATIONSHIPS. HE IS NOT IMPRESSED WITH THE ABILITIES AND EFFECTIVENESS OF THE CBI LEADERS THEMSELVES AND THEIR ABILITY TO COMMUNICATE AND CONVINCE TUC LEADERS OF THEIR POINTS OF VIEW. THEY, AND GORDON RICHARDSON, GOVERNOR OF THE BANK OF ENGLAND, HAVE BEEN ARGUING THAT WITH INCREASED PRODUCTIVITY EVERYTHING WILL COME RIGHT. UNFORTUNATELY, THIS HAS NOT ALWAYS BEEN TRUE IN THE PAST. CHANCELLOR HIMSELF DOES NOT HAVE A CLEAR VIEW ON THIS ISSUE.

13. IN RESPOLSE TO A QUERY FROM THE ECONOMIC MINISTER, THE CHANCELLOR SAID PRESSURE FOR IMPORT CONTROLS STILL EXISTS AND MAY INCREASE. ON THIS POINT, THE MOST IMPORTANT DANGER FACING THE COUNTRY IS NOT UNEMPLOYMENT, BUT RATHER THAT THE BALANCE OF PAYMENTS DEFICIT MAY NOT BE ABLE TO BE FINANCED. THIS HAS BEEN A PROBLEM SINCE THE END OF THE WAP. THERE ARE ARGUMENTS IN RESPECTABLE CIRCLES THAT MNE MEANS OF CUTTING THIS GORDIAN KNOT WOULD BE TO IMPOSE GENERALIZED IMPORT CONTROLS ON MANUFACTURED GOODS. THE TUC HAS NOT SUPPORTED THESE VIEWS.

14. THE CHANCELLOR SAID HE WAS HELPED BY SECRETARY SIMON'S REFUSAL TO COUNTERVAIL AGAINST PILKINGTON GLASS. THIS ENABLED THE CHANCELLOR TO ARGUE WITH THE TRADE UNIONS THAT IF THE UK BEHAVES, OTHER COUNTRIES WILL BEHAVE, BUT THAT THE OUTCOME ON SUCH ISSUES MIGHT BE DIFFERENT IF THE UK ITSELF IMPOSES MORE GENERALIZED IMPORT CONTROLS. THE CHANCELLOR REFERRED TO THE RECENTLY INTRO-

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DUCED IMPORT CONTROLS HERE AS "MINISCULE." ON BALANCE, HE CONSIDERED THAT UNION PRESSURE FOR ADDITIONAL CONTROLS WILL INCREASE, BUT NOT CRITICALLY AS LONG AS SOME PROGRESS CAN BE SEEN ON THE ECONOMIC FRONT. HE CONSIDERED IT FORTUNATE THAT TIME LAGS BETWEEN OUTPUT CHANGES AND FALLS IN UNEMPLOYMENT ARE PROBABLY LESS IN THE UK THAN IN OTHER MAJOR COUNTRIES.

15. SUMMING UP, AND STRESSING THAT THE VIEWS HE WAS GIVING ARE PERSONAL, THE CHANCELLOR CONSIDERED THAT THE UK
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HAD FOR MANY YEARS PAID ITSELF TOO MUCH AND LIVED BEYOND ITS MEANS. THIS IS RECOGNIZED. THERE IS RECOGNITION OF THE NEED TO CONTROL DOMESTICALLY GENERATED INFLATION AND FOR THE COUNTRY TO LIVE WITHIN ITS MEANS. IT MUST PROMOTE NEW INVESTMENT AND MEET INTERNATIONAL COMPETITION. UNFORTUNATELY, TIME LAGS ARE INVOLVED. ONE VERY BENEFICIAL ELEMENT FOR THE UK GOING THROUGH THIS DIFFICULT PERIOD IS THE HIGH LEVEL OF UNEMPLOYMENT BENEFITS AVAILABLE. AFTER HAVING REASONED TOGETHER AS A NATION FOR 18 MONTHS, THE POLICIES ARE BEGINNING TO PAY OFF, BUT TRADE UNION CONGRESS LEADERS APPEAR TO HAVE A BETTER GRASP OF THE PROBLEMS THAN DO SOME OF THE CHANCELLOR'S OWN CABINET COLLEAGUES.

16. IN REPLY TO THE AMBASSADOR, THE CHANCELLOR FELT THAT LIVING STANDARDS MEASURED BY PERSONAL DISPOSABLE INCOME TOOK THEIR SHARPEST DROP LAST YEAR. IF PERSONAL CONSUMPTION CONTINUES TO FALL, IT IS BECAUSE OF UNCERTAINTY AND HIGH SAVINGS RATIOS. TO THE EXTENT THAT DECLINE IN LIVING STANDARDS IS REFLECTED IN THE FALL IN CONSUMER DURABLES -- PUTTING OFF PURCHASES OF CARS, TVS, GAS RANGES, ETC.. THE IMPACT IS NOT SO SEVERE. OF COURSE, THIS IS NOT TRUE FOR THE UNEMPLOYED. THE CHANCELLOR STRONGLY AGREED WITH THE AMBASSADOR THAT IT IS IMPORTANT TO STRESS POSITIVE VISIBLE TRENDS AND BUILD UP A CLIMATE OF CONFIDENCE FOR THE FUTURE, EVEN THOUGH PAIN AND DISCOMFORT STILL EXIST IN THE ECONOMIC BODY

OF THE COUNTRY.

17. IN REPLY TO A REMARK BY THE AMBASSADOR ON THE NEED OF ADEQUATE INCENTIVES TO MANAGEMENT, THE CHANCELLOR SAID HE PERSONALLY HOPED TO BE ABLE TO DO SOMETHING TO ALLEVIATE THE HIGH LEVEL OF TAX RATES ON MANY MANAGERS, BUT WITH AN INCOMES POLICY IN OPERATION IT WOULD BE HARD TO BRING THIS ABOUT. HE ACCEPTED THE POINT.

18. COMMENT. DURING THE DISCUSSION THE CHANCELLOR WAS EXTREMELY OPEN AND FORTHRIGHT. HE DID NOT TRY TO HIDE HIS CURRENT DIFFICULTIES OR FUTURE PREOCCUPATIONS AND SEEMED TOTALLY DETERMINED TO DO HIS BEST TO DEAL WITH THEM. WHEN HE WAS NOT CONFIDENT THE OUTCOME WOULD BE CONFIDENTIAL

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SUCCESSFUL OR WHERE HE FORESAW DIFFICULTIES (AS NOTED IN THE ABOVE TEXT) HE TOOK THE LEAD IN POINTING THEM OUT. IF ONE ELEMENT STANDS OUT FROM THE DISCUSSION, IT IS THE CHANCELLOR'S OWN STRONG PERSONAL DETERMINATION TO ADHERE TO THE GENERAL LINE OF ECONOMIC POLICY ALREADY STAMPED WITH HIS BRAND. THIS MUCH SAID .- AND SAID IN PRAISE - HE ALSO FREELY ADMITS THAT HE IS A POLITICIAN AND MUST FRAME HIS OWN POLICIES IN TERMS OF WHAT IS IN THE LAST ANALYSIS ACCEPTABLE TO THE INTERRELATIONSHIP OF THE TUC AND THE CABINET PRESSURES ON THE ONE HAND, AND THE UK'S INTERNATIONAL CREDITORS ON THE OTHER. HE DOES NOT HAVE MUCH ROOM TO MANEUVER.

RICHARDSON

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